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¶1. Per REF A request, following are post's responses -- keyed to ref questions -- regarding Italy's posture, priorities and concerns at the Summit on Financial Markets and the World Economy in Washington on November 15, 2008. Embassy Rome POC for further information is Economic Officer Nick Noyes at noyesnj@state.gov (OpenNet), noyesn@state.sgov.gov (ClassNet), telephone 39 06-4674-2320, or IVG (VOIP) 674-2320.

¶2. BEGIN QUESTIONS

KEY OBJECTIVES AND PRIORITIES

¶A. Italy's likely objective in attending the summit will be to demonstrate to markets that governments are pursuing a coordinated policy response to the crisis and its aftermath. Italians want the EU to present a solid united front, acting in concert with the US, especially as regards measures to inject liquidity into the financial system in order to futher thaw the interbank market and stimulate credit to businesses.

¶B. Italy will also likely seek an endorsement of a coordinated, systemic review of international financial regulation, with a view to pursue some consistency in regulatory, rating, and accounting regimes and practices.

The governor of Italy's Central Bank Mario Draghi has cited the EU monetary union as a key factor in allowing Europeans to respond to the crisis in a timely, correct and coordinated fashion. Economics and Finance Minister Giulio Tremonti has gone farther, stating publicly his desire to abolish hedge funds and create new roles for the IMF and the World Bank in supervising financial markets. Moreover, he is quoted, in the October 18 issue of The Economist as advocating radical reform of international finance and an expanded G8. (Comment: Tremonti has always expressed deep suspicions about the benefits of globalization, and a rather eclectic economic philosophy.)

¶C. While the government has not made any specific proposals as regards the aftermath of the crisis, whether in the narrow context of the financial sector, or the broader one of an expected economic slowdown, Prime Minister Berlusconi has mentioned in general terms the possibility of a stimulus package for households, and assistance to specific Italian industries, such as autos, while at the same time pledging to defend Italian banks. Our Central Bank contacts indicate the Bank will not recommend, if and when the time comes, assistance targetted at specific sectors or industries.

KEY CONCERNS

¶D. Italy's greatest concerns about the current

financial crisis are unfreezing short term money markets (including cross-border), providing liquidity for financial institutions, bolstering public confidence in bank deposits, and ensuring continued credit availability to households and to small and medium firms. Tremonti has underscored publicly the importance of "recapitalizing" Italian banks, presumably as a cautionary measure, while at the same time urging greater dynamism in the interbank market in order to keep credit flowing to firms and households. In a speech October 17, the Central Bank's Draghi said the main risk for the world economy is the possibility of tight credit conditions and the cyclical downturn reinforcing each other in a vicious spiral.

¶E. Regarding the issue likely foremost on Berlusconi's mind, it would be that the financial crisis spills over onto the real economy. While Italian banks are relatively unscathed, inefficient Italian firms stand to fare worse in a recession than their international competitors, especially if banks turn off credit lifelines, as we believe is already happening. In the wake of the dramatic drop in equity prices the previous three weeks, the GOI articulated somewhat clumsily a concern about Italian firms' vulnerability to hostile takeovers, especially from sovereign wealth funds based in countries lacking transparency of government activity (read:Libya and the UAE). At the same time, Berlusconi has urged Italians to invest in Italian stocks, notably the energy giants ENI and ENEL.

IMPACT OF THE FINANCIAL MARKET CRISIS ON THE FINANCIAL SECTOR

¶F. Italian financial institutions are relatively insulated from the crisis as they do not have on their balance sheets the types of toxic assets that have sunk financial institutions elsewhere (see refs B and C). The only major Italian institution in any way tainted by the current crisis is UniCredit, Italy's largest bank by assets, which saw fit in early October to raise additional capital (6 billion euros) to shore up ratios that had come under pressure as a result of lowered business expectations (arising from the global crisis) and the bank's acquisition spree in Central and Eastern Europe earlier in the year. UniCredit officials have discounted publicly, and privately to econoffs, press speculation that the bank was dangerously

exposed to a German real estate lender that failed earlier this month. Domestic lending to the Italian business sector had already begun to slow, albeit modestly, in the first half of 2008, according to the Italian Central Bank's quarterly lending survey. Loans to firms grew by 8.8% through August 2008, versus 9.4% in the same period a year earlier. Credit to consumers ("families") grew by only 3.3% in the first half of 2008. Central Bank officials told econoffs October 28 they remain concerned that banks will restrict credit to business further, in an effort to improve their own liquidity. Lending for mergers and acquisitions and for debt restructuring has slowed significantly more than credit for business expansion and working capital. The Central Bank's measures are aimed, therefore, at providing ample liquidity to banks in order to mitigate the contraction of credit to Italian businesses.

ACTIONS TAKEN TO ADDRESS THE FINANCIAL CRISIS

¶G. Refs B and C outline the Italian government's response to the crisis, which has consisted mainly of inujecting liquidity into the banking sector (asset-for-collateralizable-asset swap program), offering additional bank deposit guarantees, and creating facilities, as yet untapped, to bolster bank capital with public funds (asset-equity swap program). They are no plans to establish direct lending facilities for Italian firms, along the lines announced by the US Federal Reserve.

CURRENT ECONOMIC SITUATION/NEAR TERM OUTLOOK

¶H. Italian economic policy makers had been planning on a sluggish economic growth scenario (0.5%) even before the shocks of September and October. Most economists now believe the Italian economy is already contracting (zero growth in 08, slightly negative in 09) and look for growth to resume at the end of 2009 at the earliest. The government in July 2008 proposed an austere budget that cuts significantly across the board, sparing only entitlements and debt service, projecting a deficit of 2.5% of GDP,and a debt-to-GDP ratio of 103.7%. These goals could be in jeopardy given a prolonged or severe economic downturn. The GOI expects a slight deterioration in the current account as a result of lower external demand, mitigated in part by slowing Italian demand for imports, as households cut back in the face of economic uncertainty. Talk of inflation has mostly abated, as international commodity prices have nose-dived and domestic demand has slowed. The Bank of Italy projects inflation for all 2008 at 3.6%. Nation-wide wage contract negotiations are likely to result in modest nominal wage increases, paced by the government's agreement with public sector employees slated to be completed by year-end.
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